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No. 93-1987

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

SHARON PRATT KELLY, *et al.*,
Petitioners,

v.

SPRINT COMMUNICATIONS COMPANY, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the District of Columbia Court of Appeals

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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COUNTER QUESTION PRESENTED

Where the benefit of the property, sales and use tax exemptions derived from the District of Columbia's gross receipts tax on interstate long distance calls is limited to property which is both (i) within the District and (ii) used by vendors to generate in-District revenues, whether the exemptions violate the Commerce Clause by discriminating against sales into the District by vendors from surrounding states and by discriminating against sales into other states by vendors located in the District.

PARTIES

The Respondents are taxpayers, *i.e.*, long-distance telephone companies subject to the District of Columbia's gross receipts tax. They are: Sprint Communications Company, L.P.; Cable & Wireless, Inc.; LDDS Metromedia Communications Corporation; AT&T Corporation; AT&T Communications of Washington, D.C., Inc.; ALLNET Communication Services, Inc.; Metro Telecommunications Services, Inc.; Metro Telecommunications Services, Inc.; Richard J. Rice, Inc.; and RealCom Office Communications, Inc. The Petitioners are the taxing authorities, *viz.*, the Mayor, the Director of the Department of Finance and Revenue, and the District of Columbia.

RULE 29.1 LIST

Sprint Communications Company, L.P., is a limited partnership owned solely by Sprint Corporation, formerly United Telecommunications, Inc., whose stock is traded on the NYSE. Cable & Wireless, Inc., is a wholly-owned subsidiary of Cable & Wireless, P.L.C., whose stock is traded on the LSE and whose ADRs are traded on the NYSE. LDDS Metromedia Communications Corporation is a wholly-owned subsidiary of LDDS Communications, Incorporated, whose stock is traded on NASDAQ. ALLNET Communication Services, Inc., is a wholly-owned subsidiary of ALC Communications Corporation, whose stock is traded on the American Stock Exchange. AT&T Communications of Washington, D.C., is a wholly-owned subsidiary of AT&T Corp., formerly American Telephone & Telegraph Company, whose stock is traded on the NYSE. Richard J. Rice, Inc. (formerly known as Long Distance Service of Washington, Inc.), Metro Telecom-

munications Services, Inc., and RealCom Office Communications, Inc., are privately held companies.

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

The respondents respectfully request that this Court deny the Petition for a Writ of Certiorari to the District of Columbia Court of Appeals. The Petition is premature; the case does not present the issue depicted in the Petition; and the question presented is not worthy of the Court's consideration.

COUNTERSTATEMENT OF FACTS

Introduction

This case involves the statutory scheme which the District of Columbia (the "District") adopted in 1987 to tax the receipts from long-distance telephone calls.

Because the District lies wholly within a toll-free local calling area, all long-distance calls are interstate calls.

Under the legislation enacted by the District Council in 1987, a tax was imposed on the gross receipts of the long-distance companies. This new tax was imposed on the revenues of long-distance carriers attributable to long-distance calls which originated or terminated in the District and were charged to a service address there. The District conjoined this gross receipts tax with an exemption for the long-distance carriers from personal property, sales and use taxes imposed on personal property located in the District. However, the District made this exemption available to the carriers only to the extent that they used such personal property to produce in-District revenue which was subject to the new gross receipts tax. To the extent that a carrier used such personal property to produce out-of-District receipts, it was not exempt from such personal property, sales and use taxes; nor was any adjustment made if a carrier used property taxable in another jurisdiction to produce receipts in the District.

Specifically, the applicable statutory provision regarding the personal property tax states that personal property is exempt from such tax if it is:

> used or consumed in furnishing [long-distance] service if the receipts from furnishing the service are subject to a gross receipts tax in force in the District . . . except that if the personal property is used to produce receipts subject to a gross receipts tax in the District and receipts not subject to a gross receipts tax in the District, then the personal

> property tax exemption shall be allocated in accordance with rules issued by the Mayor.

D.C. Code § 47-1508(a)(3)(B) (Supp. 1989). (Appendix to the Petition ("App.") 75a).[1] Provisions accomplishing similar results were also enacted with respect to sales and use taxes. D.C. Code §§ 47-2005(5), 47-2206(1) (Supp. 1989). (App. 76a).

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[1] The District's new tax scheme was not enacted until July 17, 1987. Implementing regulations were not published in the D.C. Register until September 25, 1987. However, the gross receipts tax was retroactively imposed back to July 1, 1986. Because the statute was retroactive and because personal property taxes are paid in advance, it was too late to provide an exemption for personal property taxes allocable to the retroactive period. (Personal property taxes for the fiscal year ending June 30, 1987 were due in July, 1986; and such taxes for the fiscal year ending June 30, 1988 were due in July, 1987.) Accordingly, the enacting legislation provided that a credit against the gross receipts tax payable for the period July 1, 1986 through September 30, 1987 would be available for personal property taxes paid and allocable to that period, up to the amount of the gross receipts tax. D.C. Code § 47-2501(b)(3)(C) (Supp. 1989). Because of its retroactive features, however, it was available to carriers only to the extent that they already had property in the District, and those carriers which might have had the great preponderance of their property elsewhere during that period had no opportunity to move to the District in order to take advantage of it. For the period September 30, 1987 through June 30, 1988, with respect to which the property taxes were also due and paid in July, 1987, the District gave effect to the exemption by also allowing a credit for the property taxes allocable to that period against the gross receipts taxes due for that period. But, instead of being a credit for the full amount of such property taxes, the credit was reduced to the extent that such personal property was deemed to have been used, per regulations, to produce out-of-District receipts. *See* 9 D.C.M.R. § 3504 (1994).

The District gave effect to such limitations through regulations published in final form on September 25, 1987. 9 D.C.M.R. §§ 709.1(c), 471.3 (1994). At page 13, note 10 of its Petition for a Writ of Certiorari (the "Petition"), the District purports to set forth the regulatory formula which it adopted to give effect to the statutory requirement that the exemption from sales, use and personal property taxes be limited solely to that property which was used or consumed in producing receipts within the District of Columbia and, therefore, taxable by it. Note 10, however, is incorrect in its specification of the numerator under column (3). In the regulations, that specification reads "value of personal property everywhere on July 1 of column 1 tax year." In note 10 the District erro-

neously changed the word "everywhere" to "elsewhere".[2]

In sum, to the extent that a carrier's personal property in the District was used to produce gross receipts in other jurisdictions (and, therefore, not taxable in the District), the personal property, sales and use tax exemptions did not apply. Similarly, the statute made no provision for any credit to the extent that a long-distance carrier used personal property subject to personal property, sales or use taxes in another jurisdiction to produce receipts in the District which were subject to its gross receipts tax.

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[2] Accordingly, the formula in the regulations is correctly stated as follows:

Column (1)		**Column (2)**		**Column (3)**		**Column (4)**
Current personal property tax due before column (4) credit	x	Receipts on which District gross receipts tax is paid for twelve preceding months / Gross receipts everywhere for twelve months preceding column (1) tax year	x	Value of personal property everywhere July 1 of column (1) tax year / Value of property subject to District personal property tax on July 1 of column (1) tax year	=	Credit against Column (1) tax NOT to exceed limits of this section

See 9 D.C.M.R. § 709.1(c) (1994).

The Combined Effects of the Tax and the Exemptions, and the Mathematical Errors in the District's Description Thereof

In the table set forth at page 17 of its Petition, the graph set forth at page 19 thereof, and the accompanying textual discussion, the District purports to illustrate the interrelationship between the gross receipts tax and the personal property tax exemption and the effects thereof on carriers which, in varying degrees, use property in the District or elsewhere to produce receipts in the District. Neither the table nor the graph were part of the record below, and the conclusions the District draws from them are contrary to the conclusions of the D.C. Court of Appeals regarding the effect of the interplay between the tax and the exemptions. As that court correctly observed, under the District's tax scheme if adopted everywhere:

> "out-of-state carriers would pay more [taxes] than in-state carriers whenever the former had property subject to their home state's personal property tax but used to produce out-of-state revenues subject to another state's gross receipts tax."

(App. 22a). Nevertheless, because so much of the District's Petition is based on that table and graph, and because the table and graph, through demonstrable, mathematical errors, incorrectly describe the combined consequences of the tax and the exemptions, Respondents discuss it further.

The regulatory formula adopted by the District to give effect to the statutory command that the tax exemption is available only to the extent that the

property is used or consumed to produce in-District receipts, taxable in the District, can best be understood by focusing on the product of Columns (2) and (3) of the formula set forth in note 2, *supra*, which, stated more simply, can be expressed as:

$$\frac{\text{D.C. Receipts}}{\text{Total Receipts}} \times \frac{\text{Total Property}}{\text{D.C. Property}}.$$

The product of these two fractions times the property tax otherwise owed to the District is the amount of the property tax credit in Column (4). The limitations referred to in Column (4) are that the credit cannot exceed the personal property tax or gross receipts tax otherwise due the District.

Mathematically, the limitation that the credit cannot exceed the property taxes otherwise owed means that the product of Columns (2) and (3) will be arbitrarily set at 1 if it otherwise would be greater than 1. This constraint has effect only when the proportion of property which a carrier maintains in the District is less than the proportion of its receipts in the District, for it is only then that the product of Columns (2) and (3) would be greater than 1.

For example, if a carrier had 20% of its receipts in the District but only 10% of its property there, column (2) would equal 20/100 and Column (3) would equal 100/10. Their product would be (20/100) x (100/10) = 2; but, per the limitation in Column (4), the product of those two numbers will not be given effect to the extent that it exceeds 1. Thus, the carrier would receive a credit for the amount of property taxes otherwise owed to the District, and no more. In contrast, if the carrier maintained 40% of its prop-

erty in the District, then the product of Column (2) and Column (3) would be (20/100) x (100/40) = 1/2; and the carrier would receive a credit only for 1/2 of the property taxes otherwise owed.[3]

As applied to the first hypothetical situation described by the District on page 18 of its Petition, where both the District and Maryland are assumed to have adopted the District's tax regime and where a carrier had 40% of its receipts in the District and 60% in Maryland, the correct analysis under the regulations yields the following results:

1. Under the District's first scenario, which assumes that 10% of the carrier's property is in the District and that the balance (90%) is in Maryland:

With respect to property in the District, Column (2) = 40/100 and Column (3) = 100/

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[3] This reflects the assumptions implicit in the regulations that, in any given year, gross receipts are produced in proportion to personal property and that a dollar's worth of personal property in one state produces the same amount of gross receipts as a dollar's worth of such property in any other state. Thus, if the proportion of a carrier's property which it maintains in the District were twice as high as its proportion of sales there, then 1/2 of the property would be deemed to have been used to produce receipts in the District and 1/2 used to produce receipts elsewhere. It may be that such an apportionment formula is acceptable if used for a permissible purpose. *See Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978). But it is being used here to give effect to the statutory command that the exemption is available only to the extent that the property in the District is used to produce receipts there; and there is neither an exemption allowed for property in the District used to produce receipts elsewhere nor an adjustment made if property elsewhere is used to produce receipts in the District.

> 10. (40/100) x (100/10) = 4. So, all of the property in the District—which is 10% of the total—is exempt.[4]
>
> With respect to property in Maryland, Column (2) = 60/100 and Column (3) = 100/90. (60/100) x (100/90) = 2/3. So, 2/3 of the property in Maryland is exempt. Since 90% of the carrier's property is in Maryland, this means 60% of the total is exempt.

So, under these assumed facts, the District would have exempted 10% of the total amount of the carrier's property and Maryland would have exempted 60% of the total, with the result that 70% of all of the carrier's property would be exempt. (The District's Petition incorrectly states that 58% of the property would have been exempt.)

2. Under the District's second scenario, which assumes that 60% of the carrier's property is in the District and that the balance (40%) is in Maryland:

> With respect to property in the District, Column (2) = 40/100, and Column (3) = 100/60. (40/100) x (100/60) = 2/3. So 2/3 of the property in the District is exempt. Since 60% of the total amount of the carrier's property

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[4] The statute speaks in terms of an exemption, which the District has chosen to implement by means of a credit. But, for purposes of the discussion here, the two are essentially equivalent. If a credit is given for all of the property taxes otherwise owed, this is the same as exempting from the tax all of the property on which such tax would otherwise be imposed. Similarly, if a credit is given for 2/3 of the tax otherwise owed, this is the same as exempting 2/3 of the property from the tax.

> is in the District, this means that 40% of the total is exempt.
>
> With respect to property in Maryland, (60/100) x (100/40) = 3/2. So all of the property in Maryland—or 40% of the total—is exempt.

So, under the assumed facts in the District's second scenario, the District would have exempted 40% of the total amount of the carrier's property and Maryland would also have exempted 40% of that total, with result that 80% of the carrier's property would be exempt. (The District's Petition incorrectly states that 48% of the total would have been exempt.)

If the regulatory formula is carefully considered in the light of these examples, it is readily apparent that, contrary to the District's assertion, the property tax exemption for a carrier is maximized (and total taxes minimized) if, and only if, the proportion of its property in the taxing jurisdiction equals the proportion of its sales there. In such circumstances, Column (3) would be the reciprocal of Column (2), and their product would equal 1 for every jurisdiction. As a result, the property which a carrier had in each jurisdiction would be fully exempt.[5] In contrast, if the personal

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[5] The District does not explain in its Petition how it prepared the table on page 17 and graph on page 19. It appears that it may have produced them simply by multiplying the columns and rows. Thus, for the information in the top left-hand corner, the 1% exemption attributable to the District equals 10% x 10%, and the 81% exemption attributable to Maryland equals 90% x 90%. This, however, is equivalent to erroneously omitting Column (3) from the calculations. To illustrate by using one of the hypotheses on page 18 of the Petition as an example, if a carrier had 40% of the carrier's receipts in the District but only 10% of its property there, by failing to include the fraction defined

property were not allocated in proportion to gross receipts then, *ipso facto*, the proportion of property in at least one jurisdiction would have to be greater than the proportion of sales there. Since, as a mathematical certainty, the product of Column (2) times Column (3) for that jurisdiction would be less than 1, the property which the carrier maintained there would not be fully exempt; and the carrier would have to pay some tax thereon. Moreover, the carrier could reduce its total tax burden by reconfiguring how it distributed its facilities among the various states to bring the proportion of property which it maintained in that jurisdiction into balance with the proportion of its sales there.

The results discussed above flowing from the application of the District's regulatory formula simply underscore the purpose of its regulations. That purpose is to give effect to a statutory requirement that the personal property, sales and use tax exemptions would only be available to the extent that such property was used in the District to produce receipts there. The District, because of the mathematical errors in its table and graph, has obscured this; but the court below correctly perceived it. And as a result of that statutory requirement, a long-distance carrier based in the District which provided services outside thereof, and long-distance carriers based outside the District

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in Column (3) in the calculation, the District would erroneously have concluded that 40% of the carrier's property in the District, and 60% of its property in Maryland, was exempt from tax. Since, by hypothesis, 10% of the carrier's property was in the District and 90% was in Maryland, this would mean that the aggregate percentage of the total that was exempt would be [(.40 x .10) + (.60 x .90)] = [.04 + .54] = 58%, which is what the District's Petition erroneously asserts.

which provided services therein, both faced higher taxes than a long-distance carrier which maintained in the District only that property which it used or consumed to produce revenues there and neither used property outside the District to produce in-District revenues nor used such in-District property to produce out-of-District revenues. As the court below observed, under the District's statutory scheme, the only company which "can fully benefit from the available exemption is one that sells in District . . . only what it produces there . . ." (App. 23a)

The distortive effects of the District's scheme on the free flow of commerce are particularly acute here given the technological aspects of the carriers' business and the tri-jurisdictional nature of the Washington, D.C. metropolitan area. As the record below showed, each carrier only needs a single switch in order to serve that area efficiently; and the District's scheme would provide an incentive to split the switch into pieces proportional to sales and locate one of those pieces in the District, thereby producing inefficiencies. But, just as importantly, as the court below also correctly perceived, the distortive effects of such a scheme would be even greater if all jurisdictions adopted it. In such circumstances, a carrier would have an incentive to locate in a state only that property used or consumed in producing receipts in that state, thereby becoming a "home operator" in each rather than deciding according to general business considerations where to locate its facilities. (App. 23a)

REASONS FOR DENYING THE WRIT

I. The Petition is Premature

The decision of the D.C. Court of Appeals was not a final judgment under 28 U.S.C. § 1257. Therefore,

for that reason and because substantial federal issues remain in the case which the court below has yet to decide, the District's Petition is premature and should be denied.

In the appeal below, the long-distance carriers raised several other federal issues in addition to the constitutionality under the Commerce Clause of the District's tax scheme. In particular, they also urged that the delegation of authority pursuant to which the District enacted the tax violated the Origination Clause set forth in Article I, Section 7, cl. 1 of the Constitution and that the retroactive portions of the tax violated the Due Process Clause.

Although the court below considered the Origination Clause issue and ruled against the carriers with respect thereto, it expressly declined to rule at that time on the Due Process Clause issue. Further, although it considered and held in the carriers' favor with respect to the Commerce Clause issue, it:

> [did not] enter judgment for appellants', however, "because federal law does not necessarily entitle them to a refund," and the District of Columbia may "create[ ] in hindsight a nondiscriminatory scheme." *Harper v. Virginia Dep't of Taxation, supra,* 113 S.Ct. at 2519-20. (dictum) (citing *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, supra,* 496 U.S. at 40.

(App. 26a)

Thus, under the decision of the District of Columbia Court of Appeals, the remedy has yet to be determined; and fashioning an appropriate remedy in the trial court on remand from the District of Columbia

Court of Appeals is itself a federal question raising serious federal issues which that court most likely will have to consider on an appeal from the decision in the remanded proceedings. Further, under this Court's opinion in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 40-41 (1990), there is a significant possibility that any remedy will provide less than a complete refund of the total taxes paid. As a result, with respect to the retroactive portion of the tax, it is to be expected that the court below will also have to consider in any such appeal the Due Process Clause issue on which it previously declined to rule.

For these reasons, therefore, the District's Petition should be denied as premature. In the proceedings below, no final judgment has yet been entered; and the proceedings below on remand are not merely ministerial or otherwise a foregone result. Instead, they will raise significant federal questions about which it is expected there will be substantial dispute. In addition, whatever may be the outcome on remand in fashioning a remedy with respect to the Commerce Clause issue, other federal questions remain in the case on which the court below declined to rule but which it is to be expected it will still have to consider.

II. The Petition Does Not Raise an Important Federal Question

The District does not assert that the decision below conflicts with the decision of another state court of last resort or of a United States Court of Appeals. It also does not assert that the court below has decided a federal question in a way that conflicts with applicable decisions with this Court. Nor does it assert that the decision below calls into question the validity of similar statutes in a great many other states.

At best, what the District seems to assert, albeit impliedly rather than directly, is that the decision below raises an important question of federal law which has not been decided. That is not the case, however. As the unanimous opinion of the court below demonstrates, its decision was a simple and straight forward application of this Court's decisions in *Boston Stock Exch. v. State Tax Com.*, 429 U.S. 318 (1977); *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); and *Tyler Pipe Industries, Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987). Furthermore, the factual premise upon which the District bases the question it seeks to present—i.e., that its scheme does not favor locally-based taxpayers—is wrong. As the discussion above shows and the court below found, the tax does advantage locally-based taxpayers over those seeking to provide service from without the District. (App. 23a) Therefore, the facts of this case do not raise the question which the District asks this Court to review.

A. Contrary to the District's Apparent Position, This Is not an Apportionment Case

It is important to note that this case does not present an apportionment-type of issue, despite the apparent impression which may be created to the contrary by the District's reliance in its Petition upon *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dep't of Treasury*, 490 U.S. 66 (1989); and *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991). The carriers did not argue on appeal that, absent the discriminatory exemptions, the District was taxing more than its fair share of their gross receipts. And they freely concede that the District could tax all of their personal property there. So, unlike those cases, there is no issue here regarding whether the District is taxing more than its fair share of an apportionable tax base. Therefore, the principle for which the District cites those opinions—i.e., that an apportionment formula which has a rational basis will be sustained—is irrelevant here.

Instead of apportionment, the issue in this case is the geographically discriminatory feature of the District's tax regime. This Court has made plain that a fairly apportioned tax can still be unconstitutionally discriminatory if it is conjoined with credits which are based on discriminatory categories. *Westinghouse Electric Corp., supra.* " 'Fairly apportioned' and 'nondiscriminatory' are not synonymous terms." *Id.*, 466 U.S. at 397. *Cf. Amerada Hess Corp.*, 490 U.S. at 75. And, while a state is accorded great latitude in fashioning an apportionment formula so long as the

formula rests on a rational relationship and does not yield results out of all appropriate proportion with the taxpayer's business there, taxes which are otherwise discriminatory are sustained only if they satisfy exacting standards of equality through compensating or other adjustments. *Compare Barclays Bank PLC v. Franchise Tax Board of California*, 62 U.S.L.W. 4552, 4556 (June 20, 1994) (quoting from *Container Corp. of America v. Franchise Tax Bd.*) *with Associated Indus. v. Lohman*, 114 S.Ct. 1815, 1820-1822 (1994).

B. The District's Tax Scheme Falls Squarely within the Scope of this Court's Decisions in *Armco, Inc. v. Hardesty* and *Tyler Pipe Industries, Inc. v. Washington State Dep't of Revenue*

The District's tax unabashedly discriminates on the basis of geographic location. By its own admission, the District imposed its gross receipts tax in lieu of personal property, sales and use taxes imposed on personal property used in the business of providing interstate long-distance telephone service. The exemptions from those latter taxes, however, are not generally available for all property in the District used in providing such long-distance service anywhere. Instead, they are available to the extent, and only to the extent, that the property is used or consumed in the District to produce receipts in the District. To the extent that such property is used in the District to produce receipts outside the District, the exemption is not available. Similarly, to the extent that a carrier uses property outside the District in some other jurisdiction to produce receipts in the District and taxable therein, no corresponding adjustment is made for

any taxes imposed by the foreign jurisdiction on such property.

The result of such a tax scheme is to burden interstate commerce by creating an incentive for a long-distance telephone company to assure that it locates in the District, rather than elsewhere, the personal property used or consumed in producing the taxable receipts it realizes there. Further, applying the internal consistency test, if each jurisdiction adopted a similar tax, the result would be that every company would situate in each state the exact amount of facilities needed to produce telephone calls in that state, and not a jot or a tittle more. It would be penalized if it chose to locate proportionately more of its facilities in some other jurisdiction and provide the service from without.

This Court has twice in the recent past considered a tax structure like that adopted by the District here, i.e., the imposition of dual levels of taxation with exemptions from one such level dependent upon the extent to which the taxpayer produces in the state the goods or services which it sells there so that it is subject to tax at the other such level. *See Armco, Inc.* and *Tyler Pipe Industries, Inc.* In both instances, this Court found that the taxes unconstitutionally favored locally-based businesses over businesses based in other jurisdictions. In the process, it rejected claims that the combination of tax and exemptions could be justified on the basis that one tax was "compensating" for the inability to apply the other. And, further, it rejected claims (also made by the District here) that the out-of-state business could avoid double tax simply by moving to the local jurisdiction, noting that such

economic compulsion was what the Commerce Clause was intended to prevent. *See also Boston Stock Exch.*

Tyler Pipe Industries, Inc. involved so-called "compensating" taxes on manufacturing activities and on gross sales. There, the state of Washington imposed a gross sales tax on all transactions within the state, both those sales made by in-state manufacturers as well as those made by out-of-state manufacturers. Additionally, it imposed a tax on manufacturing activities. It exempted from the manufacturing tax, however, that portion of the manufacturer's local output which was sold within the state. Thus, local manufacturers paid a tax on their local gross sales and were exempt from any manufacturing tax with respect thereto. Out-of-state manufacturers were also subject to the gross sales tax on their sales in Washington, but with no credit or other relief therefrom if they were also subject to a manufacturing tax in their home states. This Court found that the tax impermissibly discriminated against both local manufacturers which sold out-of-state and out-of-state manufacturers which sold within the state. *See Tyler Pipe Industries, Inc.*, 483 U.S. at 240-41, 243, 248.

The District's tax, with its various exemptions from personal property, sales and use taxes with respect to personal property used to produce the taxable gross receipts, acts in precisely the same discriminatory fashion as the tax regimes which were voided in *Armco, Inc.* and *Tyler Pipe Industries, Inc.* Just like the in-state manufacturers in *Tyler Pipe Industries, Inc.*, a telecommunications company which has personal property in the District is exempt from taxes thereon to the extent that it uses or consumes that property to produce receipts in the District. To the

extent that it uses its property there to produce out-of-District receipts taxable elsewhere, however, the exemption is not available. By the same token, just like the out-of-state manufacturers in *Tyler Pipe Industries, Inc.*, a telecommunications company which holds its property outside the District would be liable for the full amount of the gross receipts tax for receipts derived from the District with no relief for any personal property, sale or use taxes levied on the property it used to produce those receipts.

Thus, the only carriers which can fully benefit from the exemptions are those which maintain as much personal property in the District as the District determines, per its regulations, are needed to produce the in-District receipts which the District taxes. And, if each state adopted the District's statutory tax structure, out-of-state operators would pay multiple taxes and home operators would pay only a single tax. A company which concentrated its facilities in one state, but provided services in many, would pay a gross receipts tax on all of its receipts and a personal property tax (and sales and use taxes) on all but a small portion of its personal property. In contrast, a company which spread its facilities among the several states so that, in each state, it would be found under the statute only to have property there which it used or consumed in producing the services which were taxable there—thereby becoming essentially equivalent to a home operator in each state—would pay a gross receipts tax, but would not pay a personal property tax, or sales or use taxes, anywhere.

In other words, under the District's statutory scheme, the only person who fully benefits from all the available exemptions is one who sells in a state

only what it produces there. Similar benefits are not available to those present locally who sell outside the state, or to those outside the state who sell within it. Such a regime clearly violates the standards of nondiscrimination adopted by this Court in *Armco, Inc.* and *Tyler Pipe, Industries, Inc.*, and the court below correctly perceived that. *See also Westinghouse Electric Corp.*, *supra*. (credits could not be made available on a discriminatory basis to reduce what was otherwise a fairly apportioned tax). Moreover, such a formula geographically constrains a multi-state operation in locating its investment and the states in which it makes sales. Such constraint is incompatible with the concept of a national market underlying the Commerce Clause.

C. This Case Does not Present the Facts upon which the District's Petition is Based or Raise Any New Issues

The District attempts to avoid the thrust of the analysis above by arguing that there nevertheless is an important question to be resolved. Primarily, it urges that its tax scheme does not favor home producers and that, to the extent that the internal consistency doctrine under *Tyler Pipe Industries, Inc.*, nevertheless would require the statute to be declared invalid, application of the doctrine should be limited in some unspecified way. *See* Petition at pp. 16-20, 24-25. Secondarily, it attempts to disparage the Constitutional significance of any discriminatory effects of its scheme by suggesting that the consequences thereof are either not substantial or are not fully controllable or predictable because of the vagaries of competition and other business factors. *See* Petition, at pp. 20-21.

As to the first point, the District's argument is based on its purported analysis, set forth in the table on p. 17 and the graph on p. 19 of its Petition, regarding the interplay between the gross receipts tax and the conjoined exemptions. It argues from that analysis that there is no correlation between the extent to which a carrier disperses its property among the various jurisdictions and the extent to which its property is exempt, so that it cannot be said that its scheme favors the home producer. As discussed above, however, its analysis in this regard is flawed by the mathematical errors it committed. Consequently, the facts simply do not present the question which the District says needs to be considered. And the further fact is that, as discussed above and as the court below recognized, the statute clearly favors home producers on its face, since it makes the exemptions available only to the extent that the carrier's property in the District is used or consumed to produce sales in the District.

As to the second point—that the discrimination is not Constitutionally significant because its results are both unpredictable and small when compared to other business issues—that suggestion does not add anything novel to the analysis, or raise a new issue for this Court to consider. The same issue was present in *Tyler Pipe Industries, Inc.* There, the optimal benefits from exemption were available only if the seller correctly anticipated the demand for its product in each state and built exactly enough manufacturing capacity there to meet that demand, and no more. Certainly, the complexities in such a calculation are the same type as, and are no less substantial than,

those which the District bewails. And they did not deter this Court from reaching its decision.

Thus, even though the optimal allocation may require exceedingly close—and perhaps fortuitous—predictions, that cannot diminish the fact that, as was the case in *Tyler Pipe Industries, Inc.*, the structure adopted by the District distorts decision-making by businesses and interferes with the free flow of commerce among the states by creating an incentive for a business to produce in a state only what it sells there in order to avoid the discriminatory treatment. Further, any doubt, in the context of a discriminatory tax, that even small differences are important was recently laid to rest in *Associated Indus.*, 114 S.Ct. at 1823, where this Court affirmed that small differences in treatment are constitutionally significant and that "close enough for government work" is no defense.[6]

Finally, the significance of the discrimination is not avoided by the fact that the services provided, whether provided by a home-based operator or by a foreign-based operator, all involve transactions in interstate commerce. In *Boston Stock Exch.*, this Court made clear that a state may not discriminate among interstate transactions based upon the extent to which one or the other might have a stronger element of "home connection." There, the Court concluded that the ability of the State of New York to tax stock

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[6] Moreover, as the District noted at p. 7-8 and n.8 of its Petition, the amounts put in issue because of the interplay of the tax and exemptions are "large" and "substantial." So, in any event, it ill-behooves the District to suggest that the taxpayers would ignore those amounts in arranging their affairs.

transfers did not permit it to establish a discriminatory scheme which compelled people who were otherwise selling stock that had some connection with New York to assure that the sale actually took place on a New York exchange. So too here, under *Boston Stock Exch.* the District may not use its ability to tax the in-District sales of long-distance telephone calls to compel the carriers providing such service to locate in the District the personal property used or consumed to produce those calls. *See also Westinghouse Electric Corp., supra* (discriminatory credit against a fairly apportioned tax for export sales shipped from New York site was unconstitutional).

In short, the exemptions are not generally available, nondiscriminatory exemptions of which any carrier can take advantage, despite the District's assertions to the contrary. It would be one thing if the District had simply exempted from its personal property, sales and use taxes personal property which was used in the District in connection with interstate telephone service. That would be a fair encouragement of economic activity within its jurisdiction. And, contrary to the assertion of the District at p.21 of the Petition, such an unrestricted exemption would not unduly advantage "home producers"—i.e., those who sold in the state only what they produced there—because it would be available to one and all, whether they used such property in connection with calls that might generate receipts in some neighboring jurisdiction or whether they used it to produce calls that generated receipts only in the District.

The District did not do that, however. It is true that, just as was the case in *Tyler Pipe Industries, Inc.*, the exemptions may be available to a carrier

which wishes to take advantage of them and move its facilities to the District; and that is what the District claimed below when it told the Superior Court that "out-of-state competitors could move to the District to take advantage of the incentives provided here."[7] (Defendants' Opposition filed January 13, 1988, at 45). Just as was also the case in *Tyler Pipe Industries, Inc.*, however, the exemptions are available only to the extent that the facilities which the carriers have in the District are used or consumed in producing taxable receipts there; and no compensating credit is provided for any taxes which might have been paid on property located outside the District but used to produce taxable receipts within. The court below correctly perceived that this was discrimination against interstate commerce which this Court has proscribed in numerous decisions.

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[7] However, with respect to the retroactive portion of the tax and exemptions, even that was not a possibility. The property which the carriers maintained in the District during the retroactive period was fixed as of the date of enactment, and the carriers could not retroactively move property to the District in order to take advantage of the retroactive exemption.

CONCLUSION

For the foregoing reasons, the Petition should be denied. It is premature. Further, in light of the obvious geographic discrimination underlying the District's statute, there is no significant federal question that this Court needs to decide.

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